IMT Asset Management AG
Austrasse 56 · P.O. Box 452
9490 Vaduz, Liechtenstein
asset@imt.li · www.imt.li

INVESTMENT OUTLOOK 02.2021

12 February 2021

The year started with a strong rally of risky assets, driven by accommodative fiscal and monetary policies and expectations that the vaccination campaign will lead to herd immunity in the second half of this year, which, in turn, could unleash considerable pent-up demand.

The Biden administration is pushing for a USD 1.9 tn fiscal package, which will come on top of last December's USD 900 bn program. Expectations are currently that Biden may find a compromise with the Republicans for a USD 1.5 tn relief package. This would still amount to 7% of GDP.

Fed chairman Jerome Powell reiterated that "... now is not the time to be talking about exit …" from monetary stimulus. Bond markets have started to reprice inflation expectations. US nominal bond yields rose from 0.9% end of December to 1.2%, and inflation expectations rose by 0.25%-points to 2.2%.

Notwithstanding the recent market moves we do see clear risks of market corrections in the coming months, which may provide interesting buying opportunities.

Trauth

Thomas Trauth
CEO – IMT Asset Management AG

THE BULLS STAY IN COMMAND

Financial markets

Risky assets have been performing strongly, driven by very accommodative fiscal and monetary policies as well as expectations for high pent-up demand later this year when the vaccination campaign will be far advanced.

Emerging market equities outperformed, driven by strong advances of Chinese and Indian stocks. Among developed equity markets, the Japanese Nikkei outperformed strongly, with the more defensive Swiss market index lagging. While technology stocks continued to rally, some cyclical sectors picked up pace, and especially energy and financials profited from a gloomier growth outlook.

Fiscal and monetary stimulus measures and the risk-on environment pushed bond yields upwards. This movement was largely driven by rising inflation expectations. The yield increase was most pronounced in the US, where US 10-year yields rose to 1.2% from 0.9% at the end of December. Credit spreads remained stable or even tightened somewhat further.

Listed private equity climbed 8.3% this year. Global REITS also performed well, up by 4.4%. The pro-growth outlook pushed cyclical commodities higher. Oil prices rose 8% in January whereas industrial metals took a breather, remaining flat in the month. Gold, however, regarded as a safe-haven asset, lost 2.7% in January.

The USD weakened considerably in 2020. Being short the USD became a consensus trade and short positions were elevated at the End of last year. This may explain the rebound of the USD in January. However, since the yield advantage of the USD has significantly shrunk and the US Fed will continue to pursue an aggressive asset purchase program, the outlook for the USD remains bearish. After Brexit, the GBP rebounded since it had probably become undervalued. The Chinese CNY remained on the strong side as the Chinese growth outlook continues to be positive.

Positioning and fund flows

The risk-on environment is also reflected in fund flow and positioning data. Multi-asset managers in the US and Europe increased their equity allocation to 60% from 49%, the highest levels since 2014. Flows into small- and mid-cap funds, as well as into technology, finance and energy outpaced other equity segments. At the same time, cash and bond allocations were reduced.

An interesting phenomenon is the increasing importance of retail investors, both in shares and options. A strong demand by retail investors for some of the most shorted stocks led to a short squeeze of hedge funds. This caused some small-cap stocks prices to massively overshoot.

One example, GameStop, made it to the headlines. GameStop is a video game retailer facing serious challenges as it is losing busines to online competitors. Sales fell 30% in 2020. GameStop's share price was USD 18 at the beginning of the year but skyrocketed to USD 483 on 28 January. Thereafter, the share price fell back to USD 49.

Covid-19

The pandemic has infected 110 m people, with a fatal outcome in 2.4 million. The rollout of the vaccines has started slowly, except in Israel, the US, and the UK, but vaccination is now accelerating. So far 170 m doses have been administered. The vaccination rate is currently at about 6 m doses per day. With no further delays in production, herd immunity could be reached in Q3. This, however, only holds true for developed countries. A large part of the global population, living in poorer countries, may only start to gain access to vaccines in 2022.

The recent lockdown measures have helped to lower the number of new infections significantly. However, the spreading of new and more contagious variants prevents policy makers from lifting the measures. This will continue to depress economic activity.

Macroeconomics

Growth indicators have been mixed recently. The US ISM manufacturing index fell slightly, and US nonfarm payrolls came in well below expectations, at 49,000 new jobs in January. The EMU manufacturing PMI was flat in January as lockdown measures reduced economic activity.

US growth will be boosted by the planned fiscal stimulus package. President Biden is pushing for a USD 1.9 tn program. It is expected that, after negotiations with the Republicans, the figure will shrink to USD 1.5 tn. This would still amount to 7% of GDP and provide a major growth impulse.

Euro area inflation rose to 0.9% in January after -0.3%. This increase is due to a base effect in relation to energy prices and also to tax effects. Germany had lowered the value added tax rate temporarily in 2020 and has introduced a new CO_2 tax in 2021. While energy prices will continue to drive inflation higher, there is so far no general trend of increasing consumer prices.

Monetary policy

At its policy meeting on 21 January the ECB kept interest rates and its asset purchase programs unchanged. ECB president Christine Lagarde warned in a recent speech that the removal of the stimulus programs must take place gradually to avoid the sort of mistakes made in the past, when withdrawal was affected too rapidly.

Meanwhile, and not entirely in line with the ECB, Jens Weidmann, the head of the German Bundesbank, warned that German inflation could rise above 3% this year and that rising inflation could require a tightening of monetary policy.

At its 27 January meeting the Fed kept rates unchanged at close to zero and its asset purchase program likewise unchanged. Jay Powell warned that the battle against the recession is not over and the accommodative policy needs to remain in place. In our view, however, there is a risk that the Fed could come under pressure to normalize monetary policy sooner than many observers expect. First, the massive additional fiscal stimulus planned by the Biden administration is likely to be inflationary. Second the weakening USD is likely to drive prices for imported goods higher. Third, inflation expectations have already started to rise.

Outlook

Extraordinary stimulus programs and an unprecedented global vaccination campaign have improved the outlook for a swift recovery in 2021. While equities are undoubtedly expensive and certain segments of the market appear to be in bubble territory, there might be additional upside. Pent-up demand unleashed in the second half of the year may provide additional support for equity markets.

Based on overheated markets, elevated valuations, and possible hiccups during the vaccination campaign, we see heightened risks of equity market corrections in the coming months. This, however, may provide attractive buying opportunities.

Another risk, we are monitoring closely is an inflation overshoot in the US. This could make the Fed nervous and provoke a more hawkish policy stance later this year or early in 2022.

Overall geopolitical risks look much more contained as the new Biden administration has taken a more constructive approach towards the rest of the world.

ECONOMICS

Growth indicators have been mixed recently. The US ISM manufacturing index fell slightly, and US non-farm payrolls came in well below expectations at 49k in January. The EMU manufacturing PMI was flat in January as lockdown measures reduced economic activity. US growth will be boosted by the planned fiscal stimulus package. President Biden is pushing for a USD 1.9 tn program. It is expected that after negotiations with the Republicans, the figure will shrink to USD 1.5 tn. This would still amount to 7% of GDP.

Fig. 1: PMIs

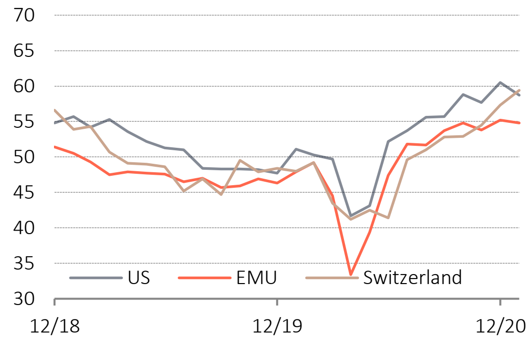


Fig. 2: PMIs

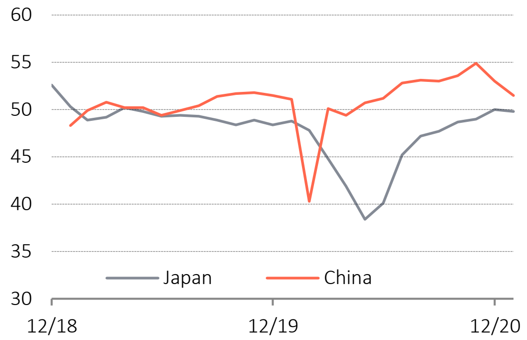


Fig 3: Consumer price inflation, in % YoY

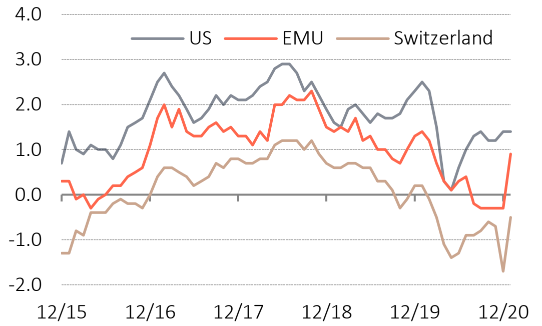


Fig. 4: Consumer price inflation, in % YoY

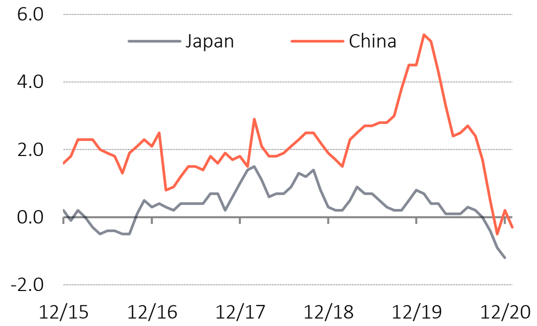


Fig 5: Unemployment rates, in %

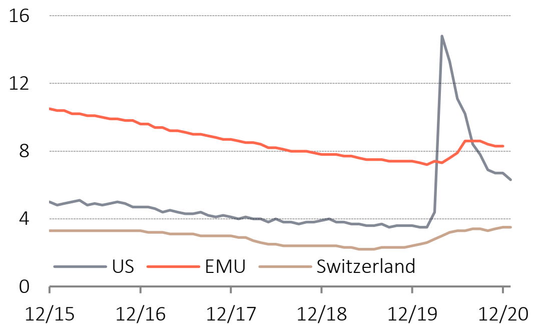
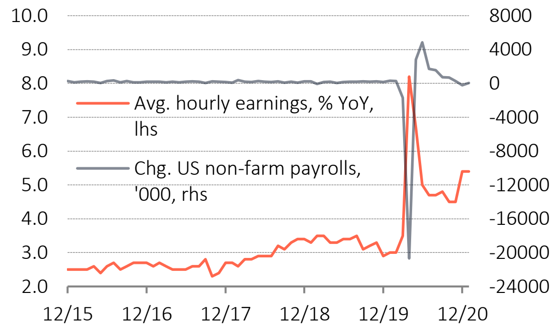


Fig 6: US labor market



FIXED INCOME

Fiscal and monetary stimulus measures and the risk-on environment pushed bond yields higher. This movement was largely driven by rising inflation expectations (see Fig. 9 below). The yield increase was most pronounced in the US where US 10-year yields rose to 1.2% from 0.9% at the end of December. Credit spreads remained stable or even tightened somewhat further.

Fig.7: 2Y government bond yields

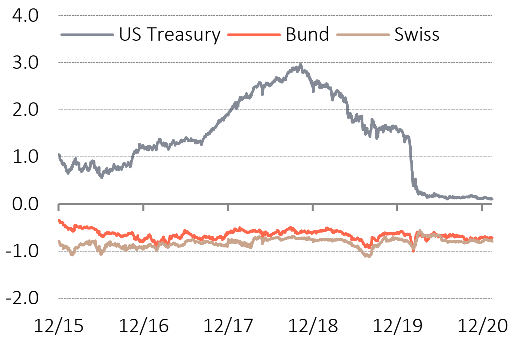


Fig. 8: 10Y government bond yields

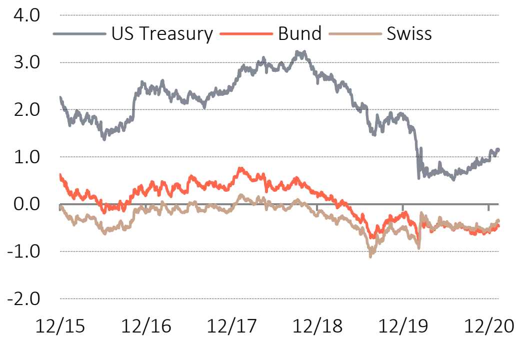


Fig 9: 10Y break-even inflation

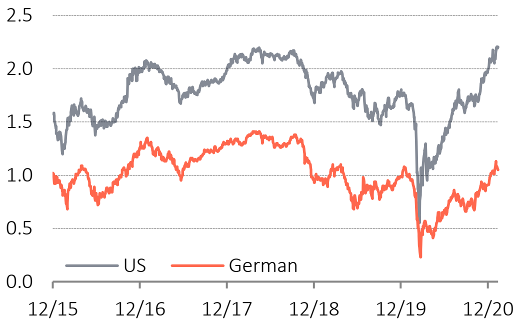


Fig. 10: Credit spreads, 5Y credit default swaps

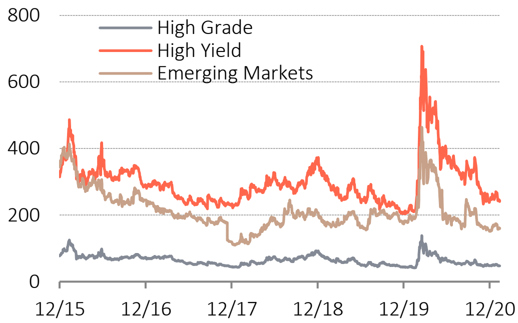


Fig 11: Money market spreads (3M-2Y)

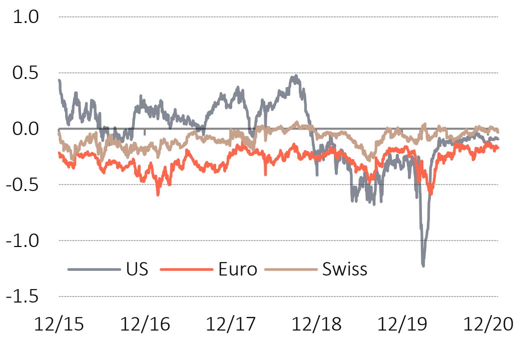
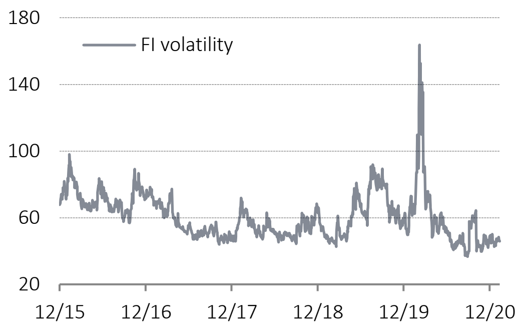


Fig 12: Merrill Lynch volatility index (MOVE)



EQUITIES

Equity markets started the year on a strong footing. Emerging markets outperformed, driven by strong advances of Chinese and Indian stocks. Among developed equity markets, the Japanese Nikkei outperformed strongly, with the more defensive Swiss market index lagging. While technology stocks continued to rally, some cyclical sectors picked up pace, and especially energy and financials profited from a gloomier growth outlook.

Fig. 13: MSCI equity indices – major regions

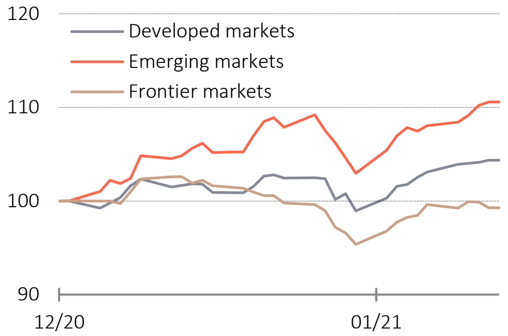


Fig.14: Equity indices – major developed markets

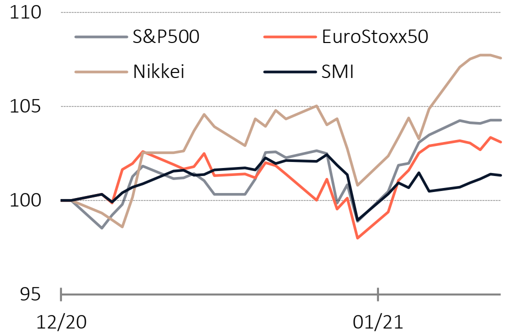


Fig 15: Equity indices – major emerging markets

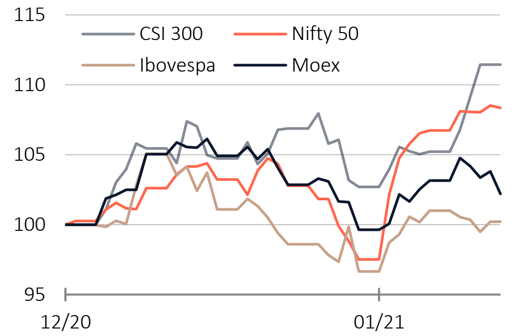


Fig. 16: Sector performance, MSCI Europe, YTD

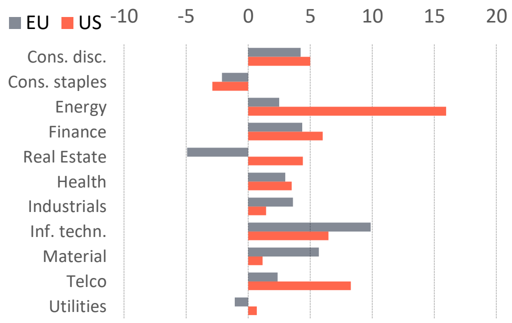


Fig 17: Price-earnings ratios

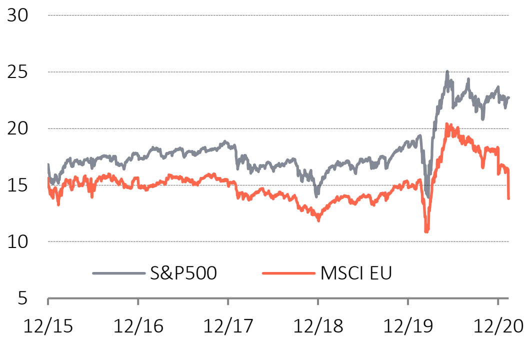
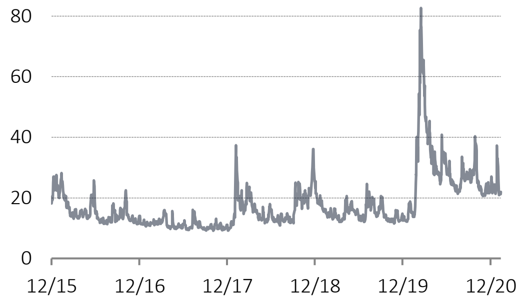


Fig 18: Equity volatility – S&P500 VIX index



ALTERNATIVE INVESTMENTS

Listed private equity climbed 8.3% this year. Global REITS also performed well, up by 4.4%. The pro-growth outlook pushed cyclical commodities higher. Oil prices rose 8% in January, whereas industrial metals took a breather, remaining flat in the month. Gold, however, regarded as a safe-haven asset, lost 2.7% in January.

.

Fig. 19: Gold price, USD/oz

Fig.20: Brent oil price, USD/bl

Fig 21: Bloomberg commodity indices

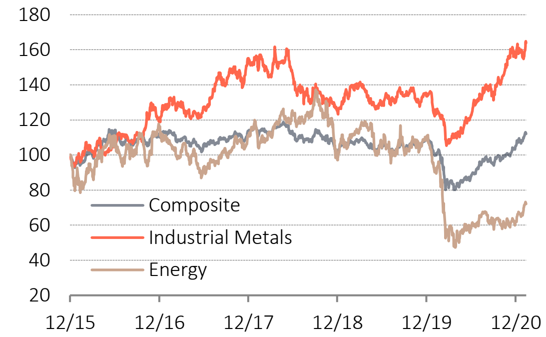


Fig. 22: HFRU hedge fund indices

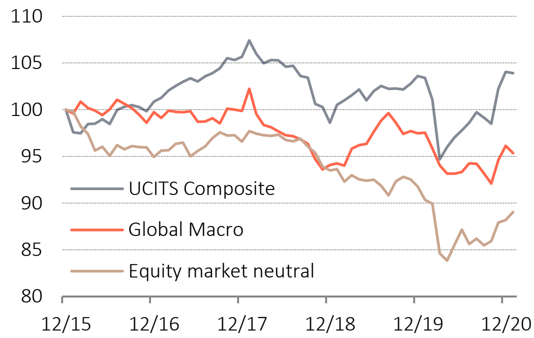


Fig 23: FTSE EPRA/NAREIT global REITS index

Fig 24: LPX global listed private equity

CURRENCIES

The USD weakened considerably in 2020. Being short the USD became a consensus trade and short positions were elevated at the End of last year. This may explain the rebound of the USD in January. However, since the yield advantage of the USD has significantly shrunk and the US Fed will continue to pursue an aggressive asset purchase program, the outlook for the USD remains bearish. After Brexit, the GBP rebounded, since it had probably become undervalued. The Chinese CNY remained on the strong side as the Chinese growth outlook remained positive.

Fig. 25: EUR-USD exchange rate

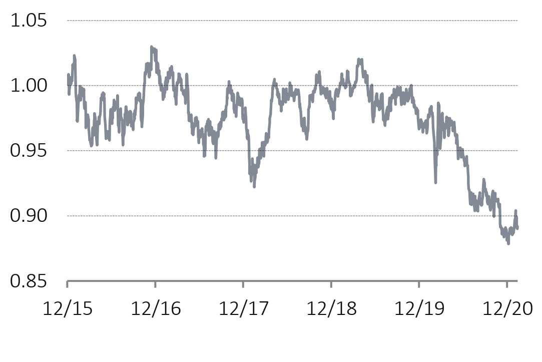
Fig. 26: GBP-USD exchange rate

Fig 27: USD-JPY exchange rate

Fig. 28: USD-CNY exchange rate

Fig 29: EUR-CHF exchange rate

Fig 30: USD-CHF exchange rate



COVID-19

The pandemic has infected 110 m people with 2.4 m fatal outcomes. The rollout of the vaccines has started slowly, except in Israel, the US, and the UK, but is now accelerating. So far 170 m doses have been administered. Currently the daily rate is at almost 6 m doses. With no further delays in production, herd immunity could be reached in Q3. At the same time, the lockdown measures have helped to lower the number of new infections significantly. However, spreading of the new and more contagious variants is keeping policy makers from lifting the measures.

Fig. 31: Total Covid-19 cases (x 1000)

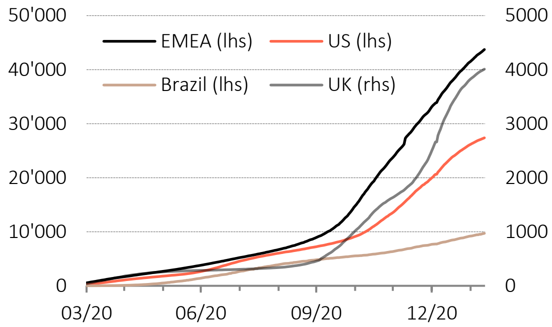


Fig. 32: New cases per day (7-day average)

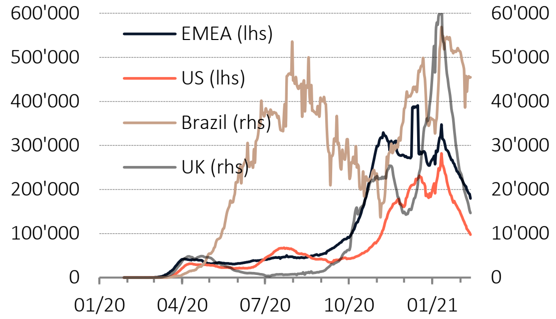


Fig 33: Global vaccination campaign (doses per 100 people)

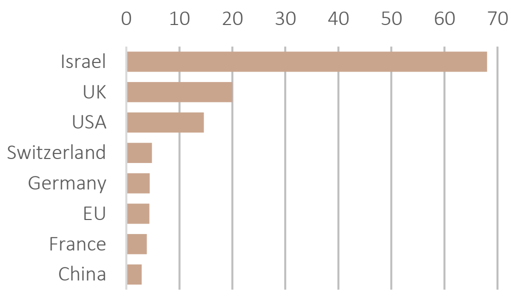


Fig.34: Central bank total assets (indexed)

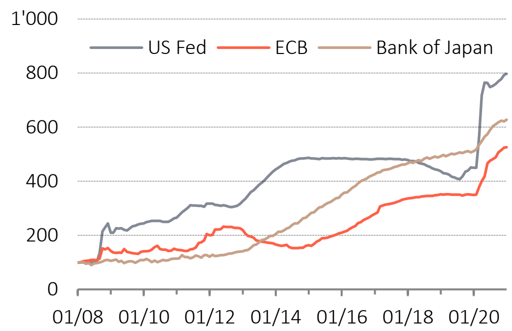
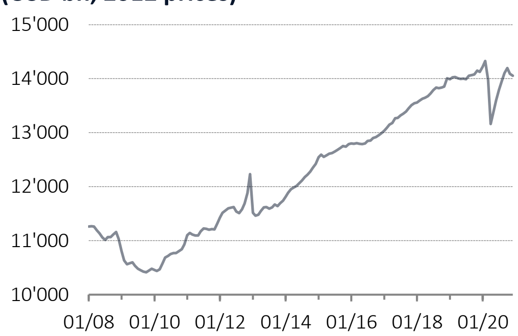


Fig 35: US bankruptcy index

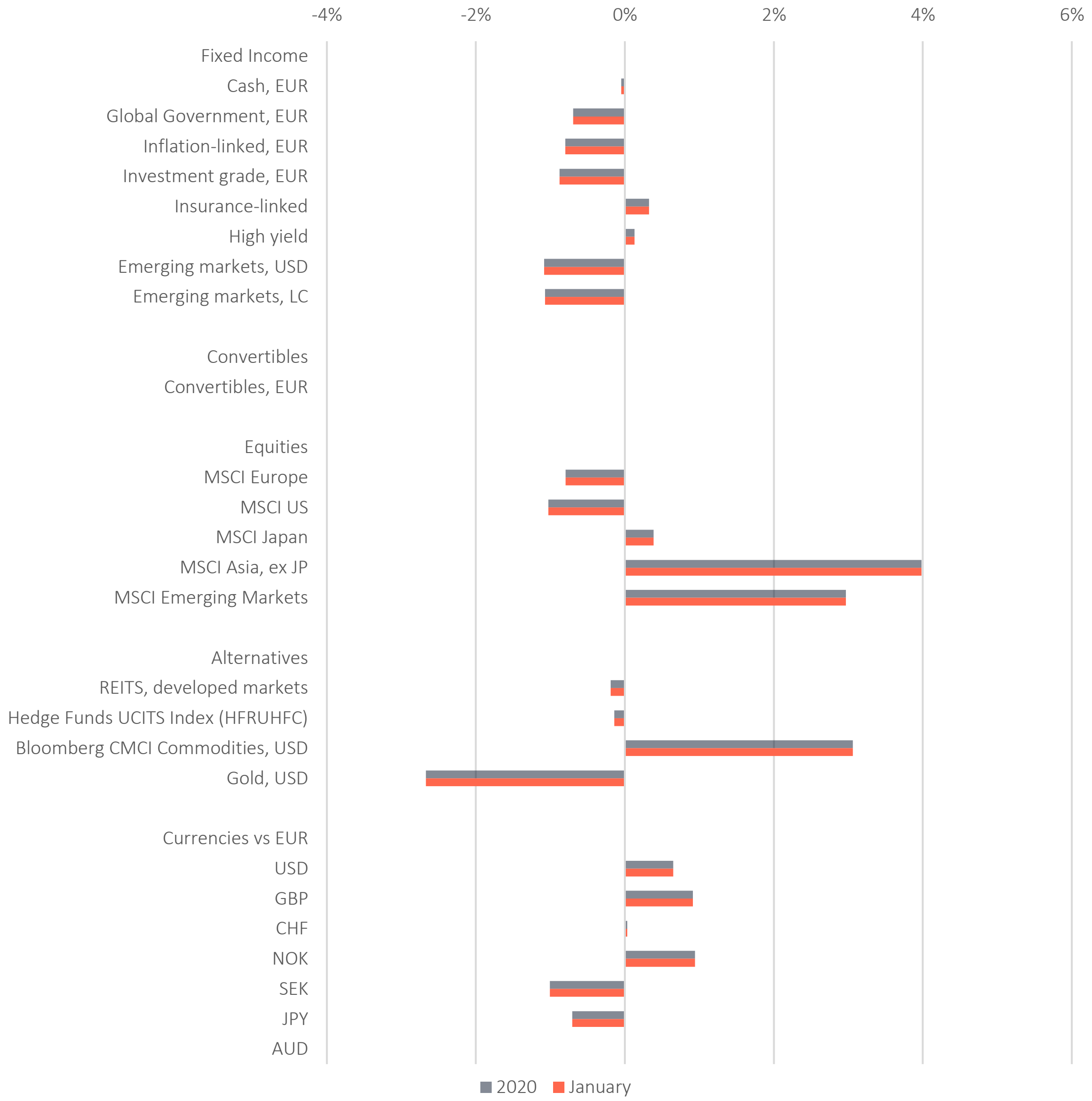
Fig 36: US personal income, excl. transfers (USD bn, 2012 prices)



ASSET ALLOCATION

Financial markets performed very well at the beginning of 2021. However, during the last week of January markets corrected temporarily. As a result, the January performance was mixed. Emerging markets equities were the major performance driver. Almost all fixed income segments lost in January, except for insurance-linkers and high-yield. Oil prices surged, whereas gold prices dropped. Foreign currencies, especially USD and GBP, performed well.

Fig. 37: Performance of major asset classes, based on our EUR portfolio strategy

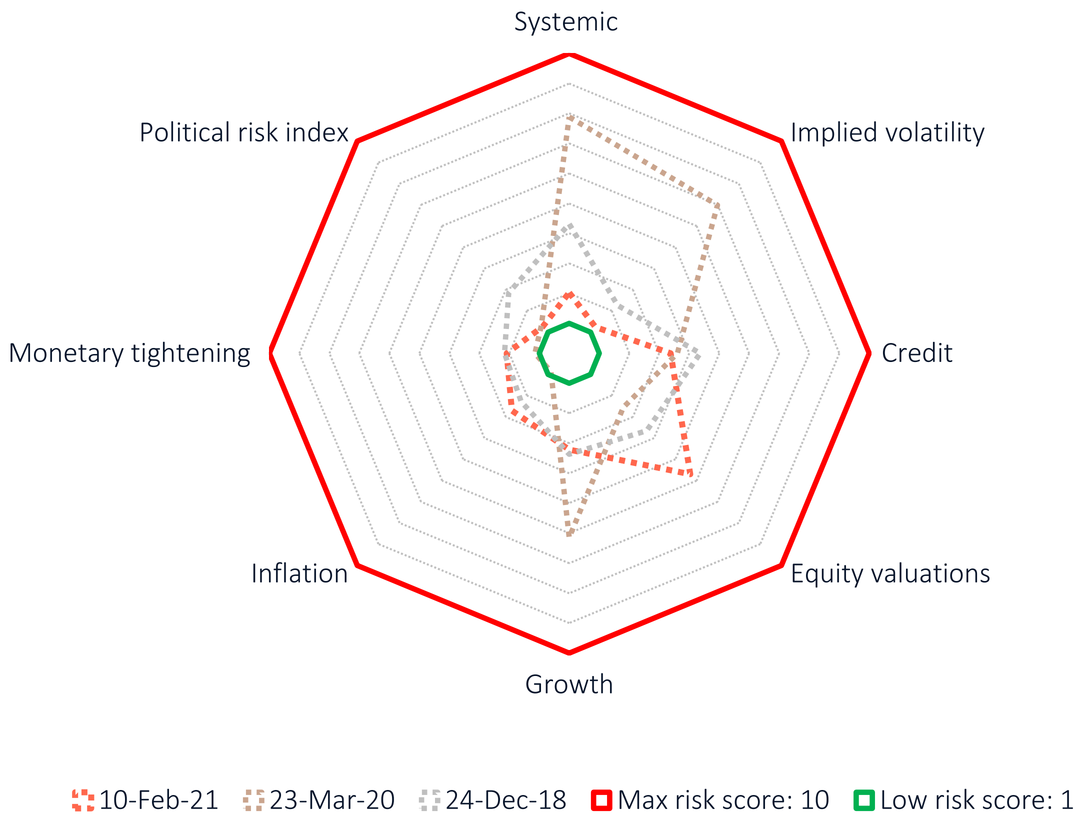


RISK MONITOR

The risk landscape remains little changed compared to previous months. Equity valuations have gone up a bit more while growth risks have subsided. Most other risk indicators remain very low compared to historical averages. Monetary conditions remain very loose with no change expected any time soon.

Fig. 38: IMT Risk Monitor

23-Mar-20: Pandemic
24 Dec 2018: Growth and monetary tightening fears



DISCLAIMER

Source for all graphs: IMT Asset Management AG, Bloomberg, Real Clear Politics, for Fig 36 Statista (de.statista.com), for Fig. 38, the political risk index: "Measuring Geopolitical Risk" by Dario Caldara and Matteo Iacoviello at https://matteoiacoviello.com/gpr.htm.